



July 12, 1994
Room 15 Capitol

28th Meeting



LEGISLATIVE COMMISSION ON PENSIONS AND RETIREMENT

MINUTES

Senator Phil Riveness, Chair of the Legislative Commission on Pensions and Retirement, called the meeting to order at 2:22 P.M.

Commission members present:

Representatives Mindy Greiling, Bob Johnson, Phyllis Kahn, Gerald Knickerbocker, and Leo Reding
Senators Lawrence Pogemiller, Phil Riveness, and LeRoy Stumpf

1. Approval of Minutes of Past Meetings (3/10/94, 3/16/94, 3/17/94, 3/21/94, 3/22/94, 4/11/94, 4/19/94, and 6/14/94)

Rep. Johnson moved approval of the meeting minutes of the past meetings noted above.

MOTION PREVAILED.

2. Consideration of Federal Tax Code Compliance For Certain Section 403(b) Annuity Plans

Lawrence A. Martin, LCPR Executive Director, provided background and reviewed the staff memo on this topic. He testified that the 1994 Legislature mandated that the Commission study the implications of employer matching contributions to IRS code 403(b) plans and report to the House and Senate Government Operations Committees, the House Ways and Means Committee, and the Senate Finance Committee by January 15, 1995. Mr. Martin testified that in 1992, the employer matching contribution program, established in 1988, was expanded to include contributions to 403(b) plans through a limited list of qualified insurance companies selected by the State Board of Investment. He noted that he had requested information from the eight insurance companies selected by the State Board of Investment regarding the utilization of the employer matching contribution program and, to date, had received three responses.

Sen. Riveness stated that the first issue may be whether Minnesota employers making matching contributions to 403(b) plans are in compliance with the IRS code and the second issue may be whether there should be a limit on the number of insurance companies providing 403(b) plans under the matching contribution program. Mr. Martin stated that tax compliance is the issue the LCPR has been mandated to look at by the Legislature. The issue of the maximum of ten insurance companies authorized to offer matching contribution 403(b) plans is a concern of some insurance companies who are not currently authorized to offer those plans.

Rep. Johnson stated that expansion of the number of insurance companies authorized to provide matching contribution 403(b) plans is a policy issue.

Sen. Stumpf asked about the role of the State Board of Investment and whether they have established policies or procedures in accordance with Minnesota Statutes, Section 356.24. Mr. Martin responded that the SBI selected the insurance companies but does not monitor the program.

Sen. Riveness asked whether the State Board of Investment looked at the kind of contracts the selected companies would establish with employer groups and what kind of compliance the insurance companies would require to assure IRS code compliance.

James Heidelberg, SBI Manager of Public Programs, testified that SBI went through an RFP process to hire a consultant and then went through an RFP process to select eight insurance companies out of a list of 300 to authorize to provide matching contribution 403(b) plans. He testified that SBI views its role as selecting and ongoing monitoring of the insurance companies.

Sen. Riveness asked who is responsible if 24 school districts are out of compliance with Federal IRS Code.

Mr. Heidelberg testified that the criteria by which SBI selected the companies was based on the financial ratings of the company, the fixed and variable products offered by the companies, and the service and presence in Minnesota in selling the 403(b) plans.

Rep. Knickerbocker stated that the Commission may wish to talk to someone from the Department of Commerce regarding what kind of requirements they impose on companies who may want to sell 403(b) plans in Minnesota. It was agreed to request that a representative from the Department of Commerce attend the next LCPR meeting to respond to this question and other questions members may have. Discussion followed.

Bill Ochs, President of Ochs Services and representing Minnesota Mutual (one of the eight authorized insurance companies), testified that for two years they have been working on the IRS compliance issue but do not yet have all the answers. Discussion followed.

Andrew Larson, Universal Pensions, testified that in 1986 the IRS added a code section which required that governmental plans with employer matching contributions must comply with IRS codes and certain Department of Labor requirements and demonstrate movement towards full compliance by 1996. Sen. Riveness asked whether the compliance issues are well known. Mr. Larson responded that the provisions are very well known in the private sector but not in the public sector. Sen. Riveness asked whether legislation requiring certification of compliance with IRS codes might be a sufficient state response to this issue. Mr. Larson responded affirmatively and testified that the penalty for noncompliance would be taxation of the funds in the 403(b) plans and an additional 10% penalty for participants under the age of 59-1/2.

Sen. Stumpf questioned whether Minnesota Statute requires the SBI to have a role in assuring compliance with all applicable tax laws. Mr. Larson responded that the contracts with the eight vendors for which the SBI had oversight may comply but the overall school district plan documents may not. Discussion continued.

Mr. Ochs referred to Sen. Riveness's question regarding the legislation reviewed by the Commission during the 1994 Session and testified that the language requiring certification duplicates the IRS requirement. He further testified that the legislation would require that employers make compliance certification prior to making matching fund contributions but often compliance cannot be certified until the end of the plan year when IRS testing can be completed. He would support improving the language of the legislation or communicating this information to the school districts. Sen. Riveness stated that at a minimum the state should require school districts to have a plan document prior to participation in a 403(b) matching contribution plan.

Rep. Johnson asked whether the Chair might wish to appoint a subcommittee to review the issues. Sen. Riveness responded that if the Commission is basically dealing with IRS code compliance issues, then, based on testimony at this meeting and the October meeting, the Commission should be able to come to a consensus and draft straightforward legislation that would be directive and assure that employers that are making matching contributions have a plan document, etc.

Sen. Pogemiller questioned what would be the exposure and liability if a plan was out of compliance. Mr. Larson stated that the employer might have fiduciary liability, the school board might have corporate liability, and the individual might be liable for tax consequences. Sen. Pogemiller asked for clarification. Mr. Larson stated that if a plan was out of compliance, it would affect all participants within the plan, and the participants might bring a class action suit against the governing body for breach of fiduciary duty under federal pension law. Sen. Pogemiller stated that he would like to see a legal memo on the exposure and liability of a school district if a plan is out of compliance. He also commented that rescinding authorization to make matching contributions may be a better alternative to writing laws and regulating deferred compensation plans. Discussion followed.

Donna Carlton, an independent insurance representative, testified that limiting the number of insurance companies permitted to offer 403(b) matching contribution plans is a fairness issue. She supports removing the limit. Discussion followed.

Steve Jacobson, an independent insurance representative, testified in support of eliminating the 403(b) matching contribution plans and permitting matching contributions only to 457 plans.

Richard Shager, Stillwater, MN, testified in support of continuing 403(b) matching contribution plans and in support of passing legislation that assures compliance with IRS codes. Discussion followed.

Sen. Riveness stated that at the October meeting on this topic, he would like to hear from representatives of the bargaining units to find out why they offer matching programs and whether they prefer a limited number of vendors.

Matt Newman, attorney from Minneapolis, testified that teachers find the 403(b) matching program a valuable benefit and a retention tool for valuable employees comparable to what is offered in the private sector. He further testified that SBI might have a fiduciary liability as the state agency that selected the eight insurance companies.

Alve Jemtrud, Minnesota Education Association, testified that MEA was a proponent of this plan. He testified that 24 to 25 of these matching contribution plans are collectively bargained. Information MEA has from working with William Mercer states that if the plan is collectively bargained, the IRS discrimination testing requirements do not apply. School districts use the matching contributions to phase-out severance packages or early retirement incentive packages. MEA supports compliance with IRS codes and an unlimited number of vendors. Discussion followed.

Sen. Riveness stated that the Commission would be looking at this issue again at the October meeting.

The meeting adjourned at 4:40 P.M.

July 13, 1994
Room 15 Capitol

Senator Phil Riveness, Chair of the Legislative Commission on Pensions and Retirement, called the meeting to order at 9:45 A.M.

Commission members present:

Representatives Mindy Greiling, Bob Johnson, Gerald Knickerbocker, and Leo Reding
Senators Phil Riveness, and LeRoy Stumpf

3. Consideration of Alternative Actuarial Assumptions

Edward Burek, LCPR Deputy Executive Director, briefly noted the items in members packets and reviewed the staff background memo on this topic. He referred members to page two of the memo and noted that actuarial assumptions are usually broken down into two main groups, demographic actuarial assumptions and economic actuarial assumptions. He noted that a law passed in the 1994 session authorized the Pension Commission to change the economic assumptions, if needed. Discussion followed.

Sen. Riveness stated that the Commission is not considering changes to the actuarial assumptions because of pressure to reduce or increase employer contributions. The Commission has been empowered to change the actuarial assumptions not mandated to change them.

Rep. Johnson stated that he is concerned about how the Commission makes determinations based on recommendations from the Commission-retained actuary and the funds' actuaries. One of his concerns was the Rule of 90 MSRS error when PERA data was used for MSRS causing a significant mistake. The second concern was that the actuary mistakenly determined a 1% employee and 1% employer deficiency in PERA which the actuary caught before the information was publicly distributed. He believes that the actuary should be provided with ample time to perform cost estimates to reduce the potential for errors.

Thomas Custis, Milliman & Robertson, Inc., provided members with the "Summary of Cost Results Under Proposed Assumption Changes" and a "Commentary on Recommended Actuarial Assumption Changes" and reviewed the recommendations. He testified that it is his belief that the salary and investment assumptions should be consistent from fund to fund but if the Commission determines that consistency is not necessary, the assumptions should be changed on the basis of very specific fund related justifications. Mr. Custis then reviewed the suggested change to the salary growth assumption which would change from the current 6.5% to a 5% base with an inflation component and age-related merit scale component. Discussion followed and Mr. Custis continued with his review.

Sen. Riveness questioned item #4 on page two of Mr. Custis's recommendations, the TRA Retirement Rates. Mr. Custis testified that Milliman is going to try to more accurately breakout the "other item gain or loss" category to hopefully identify its components and reduce

the catch-all characteristics of this category. Sen. Riveness stated that a change in TRA's retirement age component based on the experience study might have resulted in a \$16 million dollar a year reduction in the employer contribution as proposed by the Governor and asked if Mr. Custis was reticent to recommend the change in retirement age for TRA because of TRA's overall actuarial status. Mr. Custis responded that adoption of the change in TRA's retirement age would place a greater burden on the actuaries to monitor very closely the source of the losses in the "other item gain or loss" category. Mr. Martin further explained that the TRA valuations persistently show large "other losses" and it is unclear what is producing those losses. The retirement rates, as reflected in the TRA experience study, should be producing a gain for TRA which means whatever is producing the "other losses" in the actuarial valuations are even larger than what has been seen. Discussion followed.

Sen. Stumpf asked how can the cause of the "other losses" be determined. Mr. Custis stated that they will analyze several different factors to determine the large "other losses." Sen. Riveness stated that this demonstrates why it is necessary to look at the whole picture rather than just one component. Discussion followed.

A panel of actuaries representing the major and statewide plans came to the podium. Mark Meyer, William M. Mercer (MSRS and MTRFA actuary), was the spokesperson. The other panel members were Jay Yager, Hewitt Associates (DTRFA actuary); Dan Peterson Gabriel, Roeder, Smith, Inc. (PERA and MERF actuary); and Ira Summer and Paul Angelo, W.F. Corroon (TRA and StPTRFA actuaries).

Mr. Meyer referred members to the July 9, 1994, memorandum which was a joint response from the statewide plans' actuaries to Mr. Martin's letter regarding actuarial assumption changes. Mr. Meyer began his comments and stated that the plans' actuaries had arrived at three basic principles for the Commission to consider when selecting actuarial assumptions. The first principle is that the actuarial process be a sound process, the second is that the assumptions used should be a consensus best estimate, and the third is that the assumptions should be plan specific or demographic group specific. Mr. Meyer continued with his testimony. Discussion followed.

Dan Peterson responded to a question from Rep. Reding regarding the impact of unexpected losses of PERA members due to privatization of some employees. He testified that four years ago PERA looked at the withdrawal experience of PERA for a ten year period, changed the table used for PERA after their review and the Commission actuary's review for PERA's experience, and increased contributions close to 1% of payroll.

Ira Summer responded to a question from Sen. Riveness regarding TRA's "other losses" of \$161 million. Mr. Summer testified that historically the breakdown provided to Milliman & Robertson has been what the Commission actuary has requested and to the extent that they see that there are other factors that have a large influence on things, it is the Commission actuary's responsibility to look into those things so that there are not large unexplained loss amounts in the valuation. He testified that Corroon actuaries agreed with Milliman actuaries on the total "other loss" amount and on the investment return and mortality numbers but they do not agree with the salary increase numbers because of differences in methodology which account for approximately \$80 million of the "other losses." Mr. Summer also testified that out of the remaining \$100 million of unexplained losses \$80 million is due to the percent of payroll amortization method used for the unfunded liability. Paul Angelo further explained the TRA "other losses" number in the valuation. Discussion followed and Sen. Riveness asked what Corroon would recommend for TRA for assumption changes. Mr. Angelo responded that Corroon would recommend that it would be appropriate to change TRA's retirement age assumption at this time but not to change TRA's statutory contribution rate until they have additional experience. Discussion continued.

Jay Yager testified that DTRFA and the other first class city teacher plans have not had an experience study performed and their actuarial assumptions should not be changed without a fund specific experience study. He recommended that experience studies of these funds be performed and after they are reviewed, if assumptions changes are required, that they occur for the 1995 valuations.

The meeting adjourned at 11:40 A.M.


Jean Liebgott, Secretary